NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

"Improving the SBA's Access to Capital Programs for Our Nation's Small Businesses"

Testimony before the Subcommittee on Finance and Tax of the House Committee on Small Business

March 5, 2008

Submitted by
Anthony R. Wilkinson, President & CEO
National Association of Government Guaranteed Lenders, Inc.
215 East 9th Avenue
Stillwater, OK 74074

NAGGL Gets It.

Chairwoman Bean and members of the Subcommittee, my name is Tony Wilkinson. I am president and chief executive officer of the National Association of Government Guaranteed Lenders (NAGGL), a trade association of approximately 700 banks, credit unions, non-depository lenders and service providers who participate in the Small Business Administration's 7(a) loan guarantee program. NAGGL members generate approximately 80% of the annual SBA 7(a) loan volume.

These are difficult times for the participants of SBA loan programs. Lenders and small business owners are facing uncertain economic conditions, decreasing profitability and rising expenses. Small business owners need access to capital to succeed and the SBA offers the primary vehicle for delivering much needed, long-term capital. However, SBA loan volume is declining. The pool of active participating lenders is shrinking. Lender fees and costs continue to rise. The Administration's FY 2009 budget request calls for more cuts that will cumulatively total 28% since 2001. This means SBA will have proportionately taken more budget cuts than any other federal agency. Unfortunately, the budget cuts for the SBA have resulted in a shifting of the delivery costs to the small business owners and the SBA's lending partners. Instead of promoting capital access, the SBA's recent actions are exacerbating the problems for many small businesses and lenders.

Why the SBA is Essential

It has been long known that the SBA, through its 7(a) and 504 loan programs, is the single largest provider of long-term loans for our nation's small businesses. Recent independent reports show that these loans are a vital economic development and financing tool.

The GAO (at the request of Senator Coburn) and the Urban Institute (at the request of the SBA) recently reviewed the 7(a) loan program. GAO found that 7(a) loans went to certain segments of the small business lending market in higher proportions than conventional loans. For example, 28 percent of 7(a) loans compared with an estimated 9 percent of conventional loans went to minority-owned small businesses from 2001 through 2004. In addition, 25 percent of 7(a) loans went to small business startups, while the overall lending market served almost exclusively established firms (95 percent).

Elsewhere the GAO reports, "… SBA does track loans that go to firms in areas it considers 'underserved' by the conventional lending market. SBA defines 'underserved' by one of these federally-defined areas: Historically Underutilized Business Zone, Empowerment Zone/Enterprise Community, low- and moderate-income census tract (median income of census tract no greater than 80 percent of the associated metropolitan area or non-metropolitan median income), or rural as classified by the U.S. Census. Using this measure, SBA's analysis found that 49 Percent of 7(a) approved loans and disbursed in fiscal year 2006 went to geographic areas that SBA considered 'underserved' by the conventional market."

Additionally, the GAO reported the following:

- 7(a) loans were larger and for longer terms than conventional loans;
- 25% of 7(a) loans went to startups; and,
- SBA and OMB have overestimated program subsidy costs.

The Urban Institute, a non-partisan group, completed a study commissioned by SBA, and found the following:

- SBA programs are more effective than conventional loans in reaching minorities, women and startups;
- SBA loans are a key financing tool for creditworthy borrowers that nevertheless do not meet conventional underwriting standards; and,
- SBA loans to businesses in underserved areas represented more than 36% of total loan approvals.

The SBA concurs that "these reports validate our essential role in getting capital to underserved communities and our success in doing so**".**

Accelerating Decline in SBA Loan Volume

Even though the GAO and Urban Institute independently confirm the importance and benefits of the 7(a) program, loan volume is declining at an alarming rate. With each passing week of this fiscal year, the problem has been getting worse.

Accelerating 7(a) Loan Volume Decline

FY 2007 versus FY 2008

Date	**#**	**$**
10/1/2007	---	---
11/02/2007	- 7.8%	2.2%
11/23/2007	-12.0%	-4.1%
12/31/2007	-12.4%	-4.1%
1/25/2008	-14.0%	-5.7%
2/08/2008	-14.4%	-6.8%
2/15/2008	-14.8%	-7.1%

NAGGL has been actively communicating our concerns to the SBA regarding the loan volume decline and decreasing lender participation. Our first letter, dated December 17, 2007, addresses concerns about the excessive costs and effectiveness of SBA's lender oversight system. To date, SBA has not responded to our letter.

The second letter, dated February 25, 2008, summarizes a survey of the NAGGL membership. NAGGL members clearly state that the decline in 7(a) loan volume and lender participation is a result of "decreased profitability of SBA lending due to lender fees and costs". The SBA continues to state that fees are not an issue—even though their highest volume participants say that fees are the top problem. The SBA has yet to respond to this letter.

The third letter is dated February 25, 2008 (and supplemented with additional comments on February 29, 2008) and addresses concerns related to the proposed rule on Lender Oversight as published in the Federal Register (October 31, 2007, Vol. 72, No. 210, 61752 ff). NAGGL's comments focus on the technical components of the proposed rule, as well as overall concerns as to the effectiveness of the oversight program. We have always agreed that a strong lender oversight program is important—provided that it is accurate, beneficial and cost-efficient for both the SBA and its lending partners. Without mutual accountability and support, the mission of the SBA for America's small businesses cannot be provided through the lending community.

Each of these letters, in their entirety, are attached and made part of this testimony.

Declining Lending Participant Profitability

There are many factors involved in the decreasing profitability of 7(a) lending. The following are examples of how the SBA has transferred direct and indirect program costs from its federal budget to its lending partners:

- Onsite and offsite lender review fees;
- Delays in SBA's processing of lenders' purchase requests ;
- Lenders are now required to liquidate chattels prior to requesting that the guaranteed portion be purchased;

- Proposed increase in ongoing lender guarantee fee back to the statutory maximum of 0.550%;
- Proposed new secondary market fee; and,
- Post-purchase reviews, some as old as 6 to 7 years.

Without reasonable profits, lender participation in the program will decline, as it is now. In addition, lenders' ability to reinvest in their outreach efforts to small business owners and expand their infrastructure to meet the community's capital needs is severely diminished. At the very time the Federal Reserve is attempting to forestall a recession by reducing interest rates and by injecting liquidity in the banking system in an effort to persuade lenders to make credit available, the SBA is implementing counterproductive small business lending policies.

Concerns regarding SBA Lender Oversight Program

The SBA 7(a) program is performing well. During a presentation at NAGGL's most recent annual convention, an SBA representative acknowledged that the loss rate in the 7(a) portfolio is running about 0.5% per year. The FDIC *Quarterly Banking Profile* showed that banks had commercial loan losses of 0.5% on an annualized basis for the third quarter of 2007. For the fourth quarter, that number jumped to 0.83%. The performance of the 7(a) portfolio compares very favorably to conventional lending.

Even so, the SBA is asking the lending industry to pay for a lender oversight model provided by outside contractors. The model is not transparent, provides very little useful information for lenders, and has not been independently reviewed or validated by the GAO or another third party.

The basis for this model is a credit-scoring process. In a recent *BusinessWeek* article, the chairman of Fair-Isaacs, one of the contractors on the SBA project, noted that credit-scoring is not a valid tool to rate entire portfolios. From a presentation at one of our recent annual conferences, a Dun and Bradstreet representative explained that the predictability of the credit score diminishes as loans exceed $300,000. Conventional commercial lenders rarely (if ever) use credit scoring for loans in excess of $150,000; their experience tells them that accurate predictability declines beyond the $150,000 level. Yet the bulk of the dollars in the 7(a) program, and nearly all of the dollars in the 504 program, are from loans greater than $150,000. In the minds of our lenders, the accuracy of the lender oversight information is questionable and the benefit associated with the fees has not been adequately justified by the SBA.

We believe that unless the reasonable profitability of 7(a) lending is restored, banks will be reluctant to sustain or expand their SBA lending activity and the program will fail to reach the needs of small business in this tightening credit environment. We respectfully request that, at a minimum, the agency be directed to indefinitely suspend its imposition of lender oversight fees. Such suspension should be permanent—or at least remain in place—until a comprehensive review of the agency's lender oversight program is concluded. We do not believe this fee suspension will in any way affect the quality of SBA's oversight efforts.

NAGGL Legislative Request

In an effort to stop the decline in 7(a) volume and decrease in lender participation, NAGGL once again asks for your support of the following items:

- Increase maximum 7(a) loan size to $3 million;
- Increase maximum guarantee to $2.25 million;
- Use of the alternate size standard used in the 504 and SBIC programs;
- WAC (weighted average coupon) Pools;
- Rate Basis Other Than Prime (5-Year Constant Maturity Treasury); and,
- Suspension of Lender Oversight Fees.

NAGGL believes that the proposed changes are vital to the long-term prosperity of the SBA business loan program. Without implementation of these changes, NAGGL believes that the program will continue to become cost prohibitive for lenders and small business owners. Over the previous three years, NAGGL has requested on multiple occasions that the SBA address the last four items of the association's legislative request through regulations. To date no action has been taken on these steps that would make the 7(a) loan program more efficient and cost effective. The Committee's help in making these necessary changes statutorily would be greatly appreciated.

SBA lending partners desire to continue meeting the capital needs of America's small businesses. In these trying economic times, the importance of the SBA program is significantly enhanced. In order to deliver the SBA product, reasonable policies and procedures need to be implemented that benefit all parties involved. To reduce the cost to the SBA at the expense and burden of its lending partners does not appear to be a reasonable compromise.

I appreciate the opportunity to testify today on the SBA 7(a) program and provide suggestions for improving the public-private partnership that exists to deliver much needed capital to America's small business borrowers. Thank you for your continued support of this vital economic program.

Attachments – NAGGL's recent communications to the SBA:

December 17, 2007	Letter to Administrator Preston
February 25, 2008	Letter to Administrator Preston (results of NAGGL member survey)
February 25, 2008	Comment Letter on Proposed Lender Oversight Program Rule RIN No. 3245-AE14
February 29, 2008	Supplemental Comments on Lender Oversight RIN No. 3245-AE14

NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

December 17, 2007

The Honorable Steven Preston
Administrator
U.S. Small Business Administration
409 3rd Street SW
Washington, DC 20416

Dear Administrator Preston:

NAGGL is concerned about the deterioration in the financial markets and its impact on the economy and small business. We believe that a nationwide credit crunch is underway as lenders tighten lending criteria and reduce credit availability. This situation has been precipitated by the subprime lending crisis, an infection that is spreading to SBA's 7(a) loan program. I would like to ask your assistance in assuring the continued availability of the 7(a) program that is so critical to the U.S. economy overall.

As you know, year to date 7(a) loan volume is down 11 percent in numbers and 2 percent in volume. In these uncertain economic times, the SBA and its active lending partners are in a position to help alleviate the credit crunch and provide economic stimulus and assistance to small business. Based on SBA and FDIC data, SBA's 7(a) loan portfolio is performing as well as bank conventional small business loan portfolios. But senior management decisions at lending institutions to cut operating costs and curtail credit availability in response to the subprime situation have impacted the 7(a) program.

The overall financial health of the banking industry is detailed in the FDIC's quarterly banking profile released November 28. The FDIC report notes that nearly half of all commercial banks had lower third quarter profits from the previous year. Among other findings, the FDIC notes that the industry ROA fell to the lowest level since the 4th quarter of 2002; loan loss provisions surged to a 20-year high; and regulatory capital rations fell to six-year lows.

These facts are driving management decisions, and while declining 7(a) loan volume is the most important symptom, it is not the only symptom. Even lenders that have managed to increase or maintain their level of 7(a) lending activity report that they are suffering. Last week a major 7(a) lender told me that while its loan numbers had increased 25 percent over the previous year, absolutely no commensurate change in profitability resulted. In addition, several institutions have advised me that they do not expect to renew their NAGGL membership because their future operational plans call for suspension or termination of their participation as 7(a) and 504 program first mortgage lenders. But the real losers in these difficult times will be the small businesses that desperately need the help of the SBA and its lending partners.

NAGGL is well aware that some regard "profit" as a dirty word when it comes to assessing a lender's internal decision to participate in the 7(a) program. The hard truth is that virtually all participating lenders are organized as for-profit enterprises, which means that they have a duty to their shareholders to realize a profit from each line of business. And while most 7(a) participants subscribe to the theory of "doing good while doing well", they cannot continue participation in the program unless they maintain an appropriate level of profitability from their 7(a) operations. Given this, NAGGL believes that unless the decrease in profitability from 7(a) lending is halted, lenders will be unable to sustain or expand their SBA lending activity and the program will fail to meet the needs of small business in this tightening credit environment.

Over the past decade and more, as a result of ever increasing delegations of responsibility, and of the agency's decision to make the program self-funding, lenders have had significantly increasing operational costs associated with their 7(a) program participation. Now, SBA has once again dramatically increased the costs for lenders, particularly higher volume lenders, to participate in the program by deciding to pass along to them the agency's out-of-pocket expenses for lender oversight. Although there are a number of factors that affect lenders' decisions to reduce or halt their 7(a) program participation, based on conversations with our members, we believe that "the straw that broke the camel's back" is the recent imposition of lender oversight fees for onsite and offsite (e.g., Loan and Lender Monitoring System – L/LMS) reviews and examinations.

In the minds of our lenders, nearly all of whom are currently regulated by the FDIC, the OCC, and the Federal Reserve Board, the accuracy of the D&B information is questionable and the benefit associated with the fees has not been adequately justified by the agency. The head of a lender's SBA loan division simply cannot justify to senior management SBA's existing fees in light of the benefits received. NAGGL fully supports lender oversight, but notes that statistics indicate that performance of the overall 7(a) loan portfolio is consistent with conventional small business loans and that according to SBA statistics, the majority of the problems in the 7(a) portfolio come from a few non-depository institutions and from lenders, active and inactive, with portfolios of less than $1 million. It is principally among these lenders that the "repair" problem exists. Yet all lenders and borrowers bear the burden of these lenders portfolios never being adequately reviewed while their own portfolios are constantly reviewed.

Therefore, on behalf of our membership, NAGGL respectfully requests that the agency indefinitely suspend its imposition of lender oversight fees for banks already regulated by the Federal government, and that it establish a ceiling on the fees imposed on non-Federally regulated institutions. Such suspension should, at a minimum, remain in effect until a comprehensive review of the agency's lender oversight efforts is concluded. We do not believe this will in any way affect the quality of SBA's oversight efforts, and obviously will not affect the efforts of bank regulatory agencies.

On behalf of our member lending partners, I thank you in advance for your positive consideration of this request. We, like you, want the SBA program to be the fuel that drives the economy and moves our small business owners from success to significance. I would be pleased to meet with you to discuss our request.

Respectfully,

Anthony R. Wilkinson

Anthony R. Wilkinson
President and CEO

CC:
The Honorable John Kerry
Chairman
Committee on Small Business and Entrepreneurship
United States Senate
Washington, DC 20510

The Honorable Olympia Snowe
Ranking Member
Committee on Small Business and Entrepreneurship
United States Senate
Washington, DC 20510

The Honorable Nydia Velázquez
Chairwoman
Committee on Small Business
U.S. House of Representatives
Washington, DC 20515

The Honorable Steve Chabot
Ranking Member
Committee on Small Business
U.S. House of Representatives
Washington, DC 20510

NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS

February 25, 2008

The Honorable Steven Preston
Administrator, U.S. Small Business Administration
409 3rd Street SW
Washington, DC 20416

Dear Administrator Preston:

NAGGL has continued to monitor the subprime crisis and its effect on the 7(a) loan program. Since last fall, NAGGL and its members have been concerned with the declining SBA volume. We initially saw tightening underwriting standards and the corresponding credit crunch affect borrowers in the SBA*Express* program. Now we have recognized a systemic decline in the general 7(a) loan volume. The SBA 7(a) loan program should be expanding in this period and providing a means to assist more of the nation's small businesses; unfortunately, this is not the case during these difficult economic times.

NAGGL surveyed its members on January 29, 2008 in order to identify the reasons the SBA 7(a) program is not maximizing its effectiveness in meeting its economic and public policy goals for small businesses. Our questions were directed to members-of-record; i.e., the person member-institutions designate as being responsible for 7(a) lending. Depending upon the institution, the member of record may be the President, CEO, Division Manager, or other designee. However, it is *always* the person with direct familiarity of the 7(a) program, with knowledge of their respective 7(a) customer base, and with ongoing interaction with the agency.

This letter summarizes the results of this recent member survey. The survey was an online questionnaire sent to all 700 members-of-record who represent the lenders that provide over 80% of the annual SBA lending volume. We received approximately 250 responses—a valid and meaningful cross-section of program participants. The survey results are illuminating and I would like to briefly share them with you:

1. 81% of respondents stated that their institutions have tightened credit underwriting standards for conventional loans.
2. 67% of respondents stated that their institutions have tightened credit underwriting standards for SBA loans.
3. 61% of respondents stated that they are seeing a decline in borrower loan demand.

Each of these responses confirms that we *are* in a credit crunch and the need for the SBA 7(a) program to help small businesses is enhanced. The next group of responses shows that SBA 7(a) policies need to be modified to reach the small businesses in need:

1. The top reason for the decline in 7(a) volume is the “decreased profitability of SBA lending due to lender fees and costs”. This reason was cited more often than decreased demand due to “borrowers concerned about possible recession”.
2. 71% of respondents did not reach their profitability budget goals in 2007.
3. 74% of respondents stated that the volume decline is *not* the result of lenders shifting to conventional products. This contradicts the explanation given by the SBA for declining 7(a) volume.

Without reasonable profits, lenders are unable to reinvest in their program to reach additional small businesses. Examples of the increasing costs and fees associated with providing SBA financing and preserving the conditional guarantee include SBA mandated onsite and offsite review fees and the ongoing SBA lender fee. At the very time the Federal Reserve is attempting to forestall a recession by reducing interest rates and by injecting liquidity into the banking system to persuade lenders to make credit available, SBA’s small business lending policies are having the opposite result.

Of particular note—and an issue raised in my December 17, 2007 letter to you—is the agency’s lender oversight program. Seventy-one percent of our members believe the agency’s onsite reviews duplicate the oversight efforts of federal bank regulators. Nearly 73 percent of our members were unaware that the offsite lender oversight bill they will receive in April will be approximately four times as large as the bill they received last year. With the exception of a small handful of respondents, our members find no value in SBA’s current offsite lender review program despite being responsible for its entire cost.

Lender after lender reported that the prospective increase in lender oversight fees will have a further negative impact on 7(a) lending. Comments by lenders such as “We may chose to close down the SBA department”; “Potential decrease in activity”; “We will do less of it” were common among the lenders who responded to the survey. When NAGGL gave the respondents an opportunity to comment on what program changes need to be made, the top write-in response was “fees are too high”. This was cited three times as often as the second highest response.

Concerns regarding the adequacy of the offsite review process expressed by NAGGL’s members were confirmed in a February 18, 2008 *Business Week* article, “Credit Scores: Not-So Magic Numbers,” that raises serious concerns and accuracy issues when utilizing a predictive scoring model for large groups of loans. SBA's offsite program and its Dun & Bradstreet model appear to utilize the exact type of predictive model discussed in the article.

Mr. Administrator, the message from the lending community is clear—the current policies of the SBA, including its position on increasing lender fees, is detrimental to providing much needed capital to our small businesses and fulfilling the agency's public policy goals. In order to restore the importance of the SBA and regain the confidence of its lending partners, the SBA must address these issues and arrive at a mutually beneficial solution that is in the best interest of small businesses and the nation.

I hope you find this information useful and look forward to your timely response.

Respectfully,

Anthony R. Wilkinson

Anthony R. Wilkinson
President & CEO

NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

February 25, 2008

Mr. Bryan Hooper
Director for Office of Credit Risk Management
U.S. Small Business Administration
409 3rd Street, SW
Washington, DC 20419

RIN No. 3245-AE14

Dear Mr. Hooper:

The National Association of Government Guaranteed Lenders, Inc. (NAGGL) appreciates the opportunity to comment on the U.S. Small Business Administration (SBA) proposed changes to 13 C.F.R 120 related to the Agency's Lender Oversight Program. We especially appreciate SBA's willingness to extend the comment period for an additional 60 days in order to allow sufficient time for input on this critically important proposed rule.

NAGGL has long supported the agency's attempts to create a more effective lender oversight program. We continue to support this important objective. We understand the proposed rule is intended to provide coordinated and effective oversight of financial institutions that originate and manage SBA-guaranteed loans, and we believe that many of the provisions of the proposed rule are necessary. However, NAGGL firmly believes that the rule is fundamentally flawed and that its implementation should be postponed until the agency has the opportunity to further examine the underlying premises on which the proposed rule is based.

As the SBA knows from our ongoing dialogue, NAGGL has serious concerns about the effectiveness and appropriateness of the Risk Management System, specifically the Loan and Lender Monitoring System (L/LMS), to accomplish its stated purpose. The SBA just published its final notice on the Risk Management System on May 16, 2007, and to the best of our knowledge, has not yet undertaken any formal third-party review of the system that would determine its true predictive capabilities. This issue is of particular concern since, as acknowledged by SBA in the preamble to the final notice on the Risk Rating System, that system "has not been available throughout an entire economic cycle." In addition, as it relates to the credit scoring aspect of the Risk Rating System, we note that credit scoring is still a relatively new tool for credit measurement. Both conventional wisdom and SBA's incumbent L/LMS contractor have concluded that credit scoring is of little value for loans in excess of $300,000, an amount which represents approximately half of the 7(a) loan portfolio and a substantial portion of the 504 loan portfolio. In addition, concerns about credit scoring made national headlines as recently as February 7, 2008, when, in a cover story entitled *Credit Scores: Not-So-Magic Numbers*, <u>Business Week</u> described serious flaws in credit scoring as a predictor of loan performance. For these reasons, the association remains unconvinced that the system is an appropriate tool for identifying SBA lending institutions with portfolios and operations that require additional SBA monitoring—*or* for the expansive role that this proposed rule would give the risk management system within SBA's decision-making process as it pertains to numerous aspects of lenders' loan program participation.

Since one of the stated purposes of the proposed rule is to codify in regulation the role of the Risk Management System and L/LMS system within SBA's oversight program, NAGGL believes that its ability to accomplish the intended purposes must be empirically tested by an independent third party before these regulations are finalized. We strongly recommend that this proposed rule not be made final until such independent third-party examination is completed, and the results analyzed and included in a proposed rule.

NAGGL is generally supportive of the agency's attempts to implement a robust oversight program for SBA Supervised Lenders, but we are concerned that some provisions of the proposed rule impose on these lenders greater restrictions and reporting requirements than those imposed on federally regulated lenders. This seems especially true in the case of those designated as Non-Federally Regulated Lenders (NFRL). NFRLs are already subject to regulatory oversight separate from SBA's oversight. The language in the preamble indicates that SBA's proposed treatment of SBA Supervised Lenders is intended to be akin to the treatment of federally regulated lenders by their regulators. Therefore, NAGGL requests that additional information be included in the preamble to any Final Rule explaining *how* SBA's treatment of the lenders that it supervises would be consistent with the oversight imposed on federally regulated lenders.

NAGGL is also concerned that many of the proposed rule's provisions are inappropriately broad and vague and do not allow SBA's lending partners to know with any degree of certainty what actions the SBA would take and when. Other provisions are not balanced regarding the rights and obligations of the lenders and of the SBA, especially the timeframes that would be imposed on lenders for various actions, as contrasted with the timeframes--or complete absence of timeframes--that SBA would impose on itself. NAGGL objects to the many instances throughout the rule in which the SBA has repeatedly given itself "sole discretion" to decide various issues. The association believes that where SBA finds it necessary to give itself such broad discretion, the rule should clearly state the factors that will be considered in the decision-making process, and to the greatest extent possible, the relative weight of these factors. With those general concerns in mind, NAGGL offers these additional comments on some of the pertinent provisions of the proposed rule as they apply to 7(a) lenders. For ease of review, our comments are grouped generally under the major headings cited in the preamble to the proposed rule.

SBA Supervised Lender Regulation. NAGGL agrees that SBA has a high degree of responsibility in its oversight of lenders that are not otherwise federally regulated, including the Small Business Lending Companies (SBLCs) and NFRLs. NAGGL supports the provisions of the proposed rule that would adopt standards similar to those established by the regulators for federally regulated institutions with regard to issues such as capital, oversight and enforcement. However, we believe that the proposed rule contains provisions that impose greater restriction on SBA Supervised Lenders than those imposed on federally regulated institutions. We request that the SBA provide additional information to explain the basis for the requirements, particularly the reporting requirements that it would impose on the lenders that it supervises.

Capital Regulation. NAGGL also generally supports the proposed capital requirements, particularly as they would relate to federally regulated lenders and NFRLs. However, we have some concerns about the provisions in proposed Sections 120.471-474. In particular, we note that the provisions of Section 120.472 would give the Associate Administrator for Capital Access (AA/CA) "sole discretion" to decide that an individual SBLC would be required to maintain a higher level of capital based on his/her determination that the entity's capital level would be potentially inadequate to protect SBA from loss due to financial failure of the SBLC. And, we find the list of examples of factors that may cause this conclusion to be inappropriately broad and vague, particularly 120.472(e) and (f). We recommend that this list of examples be more fully explained in order to give SBLCs appropriate notice of the types of factors that SBA would consider. NAGGL also recommends that the decision to require additional capital be removed from the AA/CA and assigned to the Lender Oversight Committee.

Incorporation of a Risk Rating System. Until the existing Risk Rating System is further studied and validated empirically, NAGGL strongly opposes the proposed incorporation of this system into the agency's oversight program.

Various sections of the proposed regulation make the system a key component of SBA's decision-making process for at least eight issues of great importance to lenders. These include the agency's determinations regarding:

(1) A lender's continuing ability to handle all aspects of SBA lending [120.310(a)(2)];
(2) Whether a lender should be approved to securitize its loans [120.424(b)];
(3) Whether a lender meets the requirements for sales of loans or participating interests [120.433(b);
(4) Whether a lender meets requirements for loan pledges [120.434];
(5) Whether a lender should be initially approved for, or renewed, for PLP status [120.451(b)(3) and 120.451(e)];
(6) Whether a lender qualifies to be a pool assembler [120.630];
(7) How frequently a lender should be subjected to an onsite review [120.1051]; and,
(8) Whether enforcement actions should be imposed [120.1400(c)(4) and 120.1400(c)(9)].

Given the importance of these decisions to a lender's continuing ability to participate in the 7(a) program, NAGGL believes that the decision-making process should not be so heavily dependent upon the unproven SBA Risk Rating System.

Single Act Audit Provision. Inasmuch as this topic relates only to CDCs, NAGGL offers no comments on this topic.

Enforcement Policies and Procedures. NAGGL generally opposes the broad discretion that SBA would give itself throughout the regulatory provisions related to enforcement, and offer the following comments on specific provisions within the section.

Section 120.1400(b) is unclear and needs to be rewritten to clarify its meaning. Section 120.1400(c)(4) lists one of the grounds that may trigger an enforcement action against any SBA lender as "not performing underwriting, closing, disbursing, servicing, liquidation, litigation or other actions in a commercial reasonable or prudent manner . . .;" and states that evidence of this violation may be a lender having a repeated Risk Rating or an onsite review/examination assessment that is Less Than Acceptable. In addition, Section 120.1400(c)(9) would give SBA authority to impose an enforcement action for "Any other reason that SBA determines may increase SBA's financial risk (for example, repeated Less Than Acceptable Risk Ratings . . .)" NAGGL does not believe that a low lender's risk rating is necessarily indicative of a lender's lack of appropriate care in handling SBA loans. The use of the word "repeated" makes these provisions overly subjective, particularly since a lender has no way of knowing how many low risk ratings it can be assigned before it will be subject to enforcement action. NAGGL also notes that a single Less Than Acceptable rating on an onsite review/examination should not be deemed sufficient to trigger an enforcement action. Section 120.1400(c)(6) would give SBA the authority to implement an enforcement action against a lender based on SBA's determination that the lender is "engaging in a pattern of uncooperative behavior" or taking other stated actions detrimental to an SBA program ,or not consistent with standards of good conduct. This section is extraordinarily broad and SBA should provide examples of the types of behavior that it would consider appropriate to trigger imposition of an enforcement action.

Section 120.1500(a)(3), which discusses non-immediate suspensions, specifically states that a suspension or revocation would not invalidate a guarantee previously provided by the SBA. NAGGL believes this statement of intent should apply to all enforcement actions, so should be included in the introductory paragraph of Section 120.1500.

Section 120.1500(b) would provide an additional enforcement action that SBA may take against 7(a) lenders: the suspension or revocation of a lender's authority to sell or purchase loans or certificates in the Secondary Market. The stated rationale is SBA's attempt to limit a lender's risk exposure to SBA and the Secondary Market. As the SBA is aware, many lenders are reliant on access to the Secondary Market in order to continue their 7(a) lending activities, with approximately half of all 7(a) loans being sold. For these lenders, this enforcement action is tantamount to a program suspension or termination--remedies which are specifically included as separate enforcement actions. In addition, imposition of this enforcement action would create an uneven playing field: lenders that rely on the Secondary Market to carry out their 7(a) program would suffer disproportionately from the imposition of this enforcement action. Regarding the SBA's rationale for including this enforcement action, we would note that purchasers in the Secondary Market conduct extensive due diligence. It is not an appropriate role for the SBA to provide additional protection for the participants in this marketplace. Finally, as to the need for SBA to protect itself from a lender's risk exposure: even though the SBA provides a full faith and credit guarantee on the SBA-guaranteed shares of loans sold in the secondary market, the agency has very little risk of loss. Even if the SBA determines the need to repair or deny liability on any loan, it is the lender that ultimately bears the risk of loss. For the reasons noted, NAGGL strongly recommends that this provision be removed as a proposed enforcement action.

Section 120.1600 would set forth the general procedures for the SBA's imposition of enforcement actions. In accordance with this section, a lender would have 30 days, or some other period as arbitrarily established by the SBA, to file a written objection to a proposed action, other than an immediate suspension. However, under Section 120.1600(a)(3)(i) there *is no similar time limit imposed on the SBA*. Rather, the SBA would be authorized to respond "whenever it deems appropriate." Similarly in Section 120.1600(a)(3)(ii) allows itself 90 days after receiving a lender's appeal of the agency's decision for immediate suspension to advise the lender whether SBA would continue with the immediate suspension. NAGGL objects to the response times provided in each of these subparagraphs. For actions other than immediate suspensions, it would be appropriate to mandate an agency response time of no more than 60 days. Specifying a prompt response time would enable a lender to plan with some degree of certainty regarding its ongoing 7(a) operations. In the case of an immediate suspension, NAGGL believes that allowing the agency to have 90 days to make its decision—a period during which the lender would be suspended—is unreasonable and does not provide appropriate due process. NAGGL believes that decisions whether to continue a suspension should be made as soon as possible after the lender's response is received, but in no case later that 30 days from such receipt. If deemed absolutely necessary, the SBA could consider including a provision allowing for an extension of these deadlines for just cause.

Section 120.1600(a)(5) would mandate that a lender appeal the final agency decision only in the appropriate federal district court. The preamble to the proposed rule indicates that this is a change that would eliminate the role of SBA's Office of Hearings and Appeals (OHA) from the appeals process, but does not explain *why* this change is being made. NAGGL believes that the SBA should suspend imposition of this proposed change until it has provided sufficient information to lenders and other interested parties to enable them to determine that the proposed change is appropriate. Of special concern is the relative cost to and time required for a lender to appeal any decisions to OHA versus an appeal to a Federal District Court.

We also note that Section 120.1400(a) states that by making an SBA guaranteed loan, a lender would automatically be presumed to have agreed to the terms, conditions and remedies in Loan Program Requirements as issued by SBA from time-to-time and "as if fully set forth in the SBA Form 750, Loan Guaranty Agreement … ." The 750 Form available through the agency website, and believed to be the one in current use, is dated October 1983, and contains numerous significant requirements that are no longer applicable. These include requirements that a lender submit quarterly reports on the status of its loans, despite the fact that monthly reports have been required for more than a decade; that a lender pay a 1% guarantee fee on each loan, despite statutory changes to the fee structure made many years ago; and that SBA honor guarantee purchase requests within 30 days of receipt, a time frame virtually never met.

As part of its recommendations regarding the SOP 50-10 modernization, NAGGL requested that the 750 form be revised. Last November, the agency advised that it would not undertake the revision at that time. We believe that it is inappropriate for the SBA to continue to cite SBA Form 750 as the contract between SBA and its lender partners when it is so seriously out-of-date. Therefore, although not specifically related to this rule promulgation process, we again strongly recommend that SBA Form 750 be revised, or that all references to it as a controlling document be deleted from SBA's Program Requirements.

Comments on Additional Provision. Section 120.451 discusses how lenders obtain PLP status, and states that final decisions regarding PLP approvals and renewals will be made by an "appropriate Office of Capital Access official in accordance with Delegations of Authority . . . " Since the agency publishes its Delegations of Authority for information purposes only, and does not invite or consider public comment, NAGGL asserts its opinion that final decisions regarding program participation, including PLP and other special program status, should be made by the Director, Office of Financial Assistance, with input from the Director, Office of Credit Risk Management.

Finally, we are disappointed to note the nearly complete absence in the proposed rule of any reference to the public policy purpose underlying SBA's loan programs. Only in the preamble did we find any mention of the possibility that a lender's "contribution towards [the] SBA mission" would be considered as an additional factor when SBA evaluates a lender with repeated Less Than Acceptable Risk ratings to determine whether enforcement actions are necessary, or when determining whether to renew a Lender's Preferred Lender Program (PLP) status. And, nowhere in the proposed rule is there any indication that the agency recognizes that, implicit in the statutory mandate of providing credit where it is not otherwise available, is the idea that the risk in SBA's program should generally be somewhat greater than the risk in conventional lending.

From the language in the proposed rule, it is clear that SBA is attempting to model its oversight program after those of the federal financial institution regulators. And, we believe that, in many ways this is a sound strategy. We note, however, that SBA's risk of loss from its loan programs, particularly the 7(a) program, is very different from the risk of loss that would be associated with the Federal Depository Insurance program. Both the 7(a) and the 504 programs operate, and have done so for a number of years, at zero subsidy. The lenders and borrowers that participate in these programs are already bearing the risk of program loss through the fees that they pay to the SBA. In fact, since credit reform was instituted, the program fees collected in most years have contributed <u>more</u> to the Treasury than necessary to cover projected losses. And, as to the risk of loss on any individual 7(a) loan, it must be pointed out that if a lender does not fully comply with SBA program requirements or prudent lending practices, the SBA will not honor its guarantee on the loan–so again, the lender bears the full risk of loss.

Despite the SBA's stated goal of managing program risk, there is a risk that is not addressed in the proposed rule: the risk that, in its zeal to minimize the agency's risk, the SBA creates the risk that lenders will no longer be willing or able to make available the necessary capital to start and grow the small businesses that are so essential to the health of the American economy. While NAGGL continues to strongly support the overall concept of appropriate program oversight, we urge the SBA to give consideration to incorporating the mission of the program into its consideration of lender performance.

Thank you again for the opportunity to comment on this important proposed rule.

Respectfully,

Anthony R. Wilkinson

Anthony R. Wilkinson
President and CEO

NATIONAL ASSOCIATION
OF GOVERNMENT GUARANTEED LENDERS

(Supplemental Comments for RIN No. 3245-AE14)

February 29, 2008

Mr. Bryan Hooper
Director for Office of Credit Risk Management
U.S. Small Business Administration
409 3rd Street, SW
Washington, DC 20419

RE: RIN No. 3245-AE14

Dear Mr. Hooper:

By this letter, the National Association of Government Guaranteed Lenders (NAGGL) is supplementing its February 25, 2008 comment letter. Feedback from our members during the comment period makes it appropriate for us to offer additional comments, particularly related to the proposed collection of information. And, since these comments are related to that topic, in accordance with instructions provided at 72 FR 61767, we are also providing a copy of this letter to David Rosker, Office of Management and Budget.

SBA asked for specific comments on four topics: (1) whether the proposed collection of information is necessary, (2) the accuracy of SBA's estimate of the burden of the proposed collections, (3) ways to enhance the quality, utility and clarity of the information to be collected, and (4) ways to minimize the burden of the collection of information on respondents.

(1) Whether the proposed collection of information is necessary

Please refer to our comment letter dated February 25, 2008. In that letter we stated that we believed that it would be appropriate for SBA to provide more detailed information explaining how SBA's treatment of the lenders that it supervises would be consistent with the oversight imposed on federally regulated lenders. Such information is essential to allow us to appropriately address the issue of whether the data that SBA intends to collect is necessary for the proper performance of SBA's functions.

(2) Accuracy of SBA's estimate of the burden of the proposed collections

While the information provided by the SBA is insufficient for us to fully analyze this question, we believe that the estimated cost burden on lenders to comply with the proposed data collections may be understated. For example, when estimating the Baseline Costs for Small Business Lending Companies (SBLCs), SBA assumed an annual outside audit fee of $8,000 plus an additional $2,000 for in-house costs for the respondents. Given the nature of the statements to be required from the SBLCs, we believe the estimated cost may be understated, and that the actual cost to lenders may be significantly higher. We note too, that the preamble to the proposed rule indicates that there would be no increase in the baseline costs for 7(a) lenders (excluding SBA Supervised Lenders) and for Non Federally Regulated Lenders (NFRLs). We concur with that conclusion – except that we would note that no estimate is provided on the costs that would accrue to lenders against which SBA would propose to take enforcement actions. We believe that prior to the implementation of this proposed rule, the SBA should provide estimates of the costs that could be incurred by lenders in connection with their responses to the agency regarding proposed enforcement actions, as well as the information requested in our previous letter related to the costs of appealing proposed enforcement actions to a Federal District Court, as opposed to appealing such proposals to the U.S. Small Business Administration Office of Hearings and Appeals (OHA).

(3) <u>Ways to enhance the quality, utility and clarity of the information to be collected</u>

Since the inception of the “new” SBA lender oversight program, NAGGL has pointed out that much of the data that SBA believes that it needs to oversee Federally Regulated and *Other Regulated* 7(a) program participants may already be available through the Federal Regulatory entities. And, we have encouraged the SBA to take whatever steps are necessary for it to gain access to this information. We believe that the agency has made some attempts to get information already held by the Federal regulators, but we do not believe that these efforts have been whole-hearted. In this regard, NAGGL recommends that the SBA provide detailed information on the steps that it has taken to establish information-sharing opportunities between the SBA and the Federal Regulators, *and* an analysis of whether the cost burden on the lender, particularly the costs for onsite review could be reduced if such relationships were forged. We also recommend that the SBA consider whether it could seek legislative authority to gain access to Federal Regulator data if the regulatory institutions are unwilling or unable to share necessary information.

(4) <u>Ways to minimize the burden of the collection of information on respondents</u>

NAGGL has always strongly supported the development and implementation of SBA’s online application process – *e-Tran* – which was recently expanded to support some loan servicing actions. We believe that the SBA should vigorously pursue an expansion of this system, or the creation of a similar parallel system, that would provide for the automated collection of the information proposed to be required in connection with the lender oversight function.

Finally, as several NAGGL members have pointed out, in its original letter, NAGGL failed to comment on the high costs to lenders of the agency’s proposed lender oversight program, and the perception of the actual value to be derived by the lenders and by the SBA from the program. In this regard, we note that on behalf of its 700 member institutions, NAGGL provided extensive comments on the proposed rule on Office of Lender Oversight fees. Those comments had little or no effect on changing the proposed rule. So today, 7(a) lenders, faced with operating in uncertain economic times, are being required to pay fees representing their share cost of the agency’s Risk Rating System, particularly the Loan and Lender Monitoring System (L/LMS); and, for those lenders designated by the SBA to receive onsite reviews/examinations, for the actual costs of those reviews/examinations.

SBA Administrator Preston recently testified that these fees are minimal and are having little effect on lenders’ participation in SBA’s programs. We must respectfully disagree with that conclusion. Close to 250 NAGGL member-institutions responded a recent survey on 7(a) program participation. The vast majority of those respondents indicated that SBA fees are becoming a serious impediment to continuing 7(a) program participation. And, what must be considered here is that lenders are faced with a whole host of increased costs for program participation, with the lender oversight fees being only one aspect of those costs. In addition to their out-of-pocket oversight fees, lenders continue to pay high guarantee and ongoing fees on the loans in their portfolios, and they are also required to bear the costs inherent in the implementation of recent program changes. These costs arise from a number of program changes: (1) SBA’s new requirement that a lender liquidate chattels prior to requesting that SBA honor a loan guarantee, thus adversely impacting the lender’s cash flow; (2) the new absolute limitation to 120 days on the amount of interest that the SBA will pay on a defaulted loan *regardless* of how long it takes a lender to prudently handle required liquidation actions; (3)

significant delays in SBA's handling of loan purchase requests, etc. Taken together, the existing loan program fees, the new oversight fees, and the hidden fees that come with new program procedures, impose significant cost burdens on 7(a) lenders, and place the agency at risk for having even more lenders reduce or terminate their program participation. Given the current state of the economy, and the important role that small businesses play in assuring the overall health of the economy, that result would be disastrous.

Thank you again for the opportunity to comment on this important proposed rule.

Sincerely,

Anthony R. Wilkinson

Anthony R. Wilkinson
President and CEO